



# Market Volatility

February 2019

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Private Debt Plus®, TriLinc’s private debt investment strategy, aims to deliver market-rate returns through private debt loans to Small and Medium-sized Enterprises (SMEs) in select developing countries PLUS positive impact that is measurable and reportable through the Global Impact Investing Network’s (GIIN) Impact Reporting & Investment Standards (IRIS). Depending on the vehicle, the strategy combines private financing investment opportunities to meet the investment objectives.

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# What is Market Volatility?

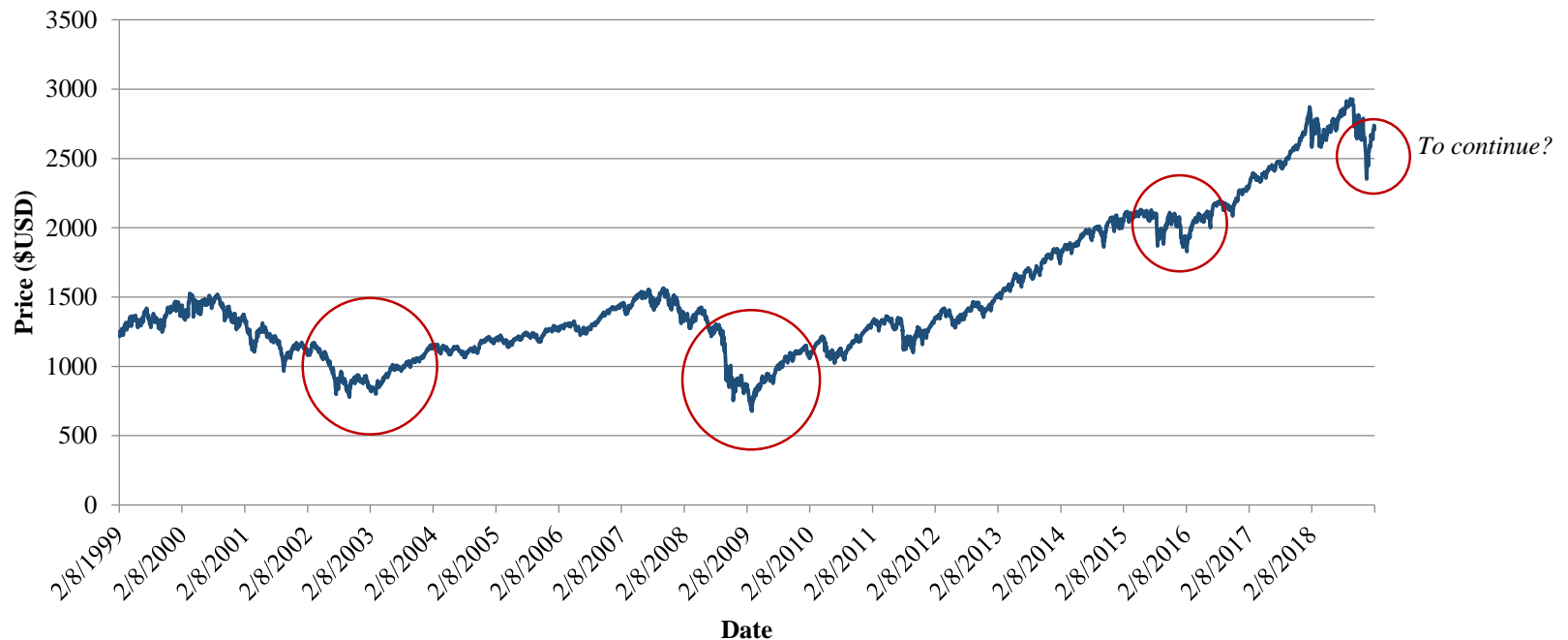
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# Defining Market Volatility

Generally, in securities markets, volatility is associated with big swings in either direction.<sup>1</sup>

### S&P 500 – Past 20 Years<sup>2</sup>



<sup>1</sup>Source: Investopedia, 2019

<sup>2</sup>Source: Yahoo Finance: S&P 500 Index, February 2019

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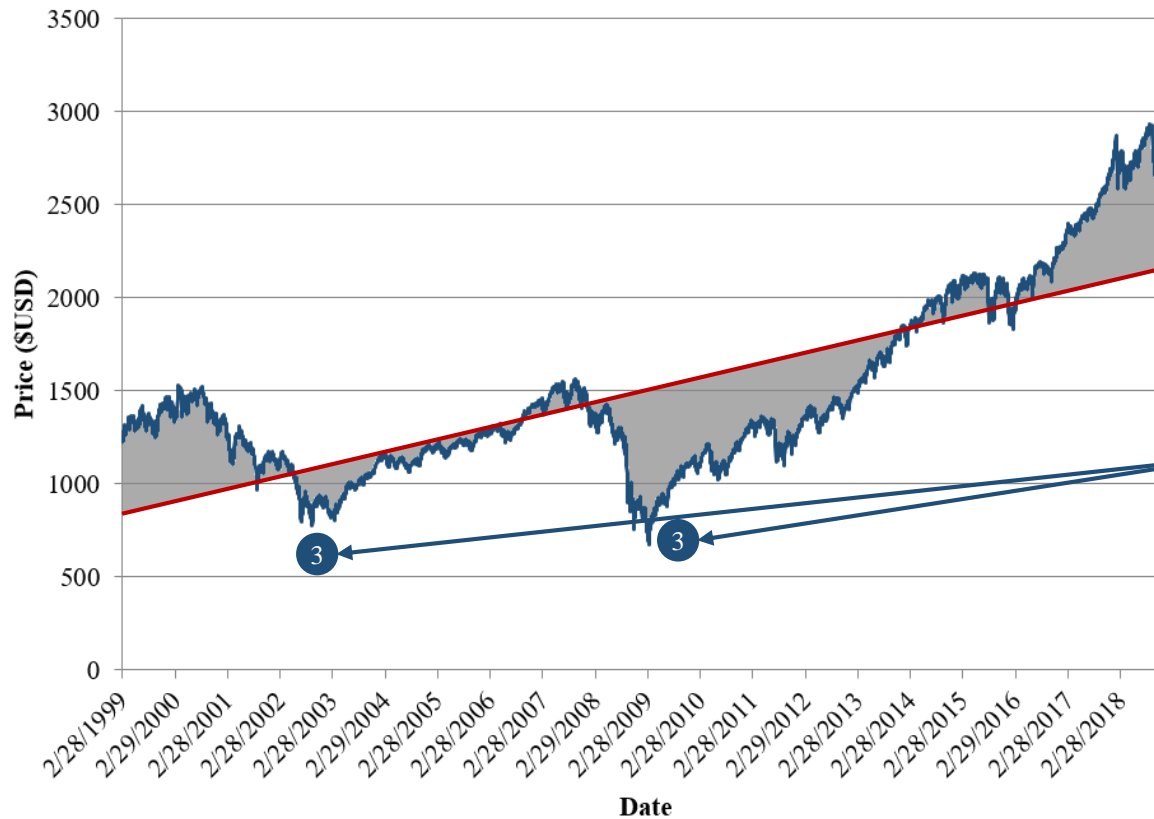
# The Impact of Volatility on a Portfolio

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# The Impact of Volatility on a Portfolio

## S&P 500 – Past 20 Years



1 Volatility can be okay if the long-term trend is positive and you have a long-term outlook.

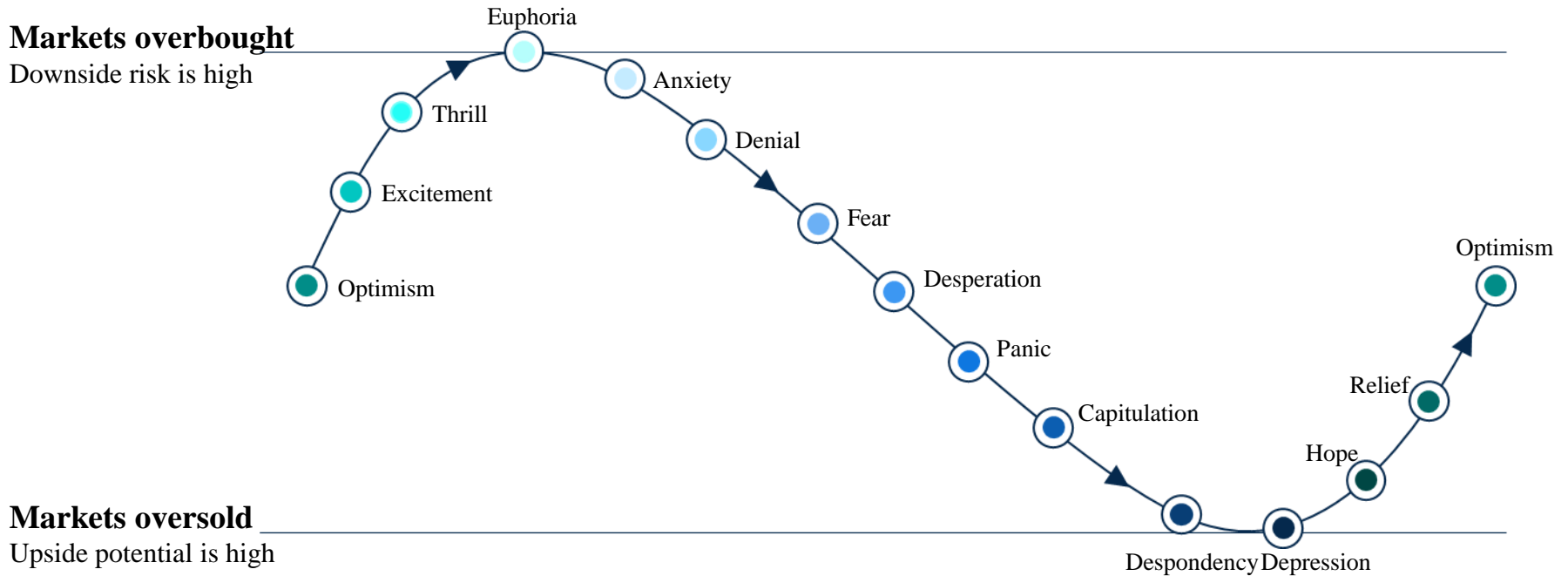
2 Volatility can be used to capture alpha, but adds risk

3 Can be damaging if investors exit at the wrong time

Source: Yahoo Finance: S&P 500 Index, February 2019  
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# Investor Emotions

## The cycle of investor emotions



Source: Gilligan Rowe & Associates, 2016. For illustrative purposes only.

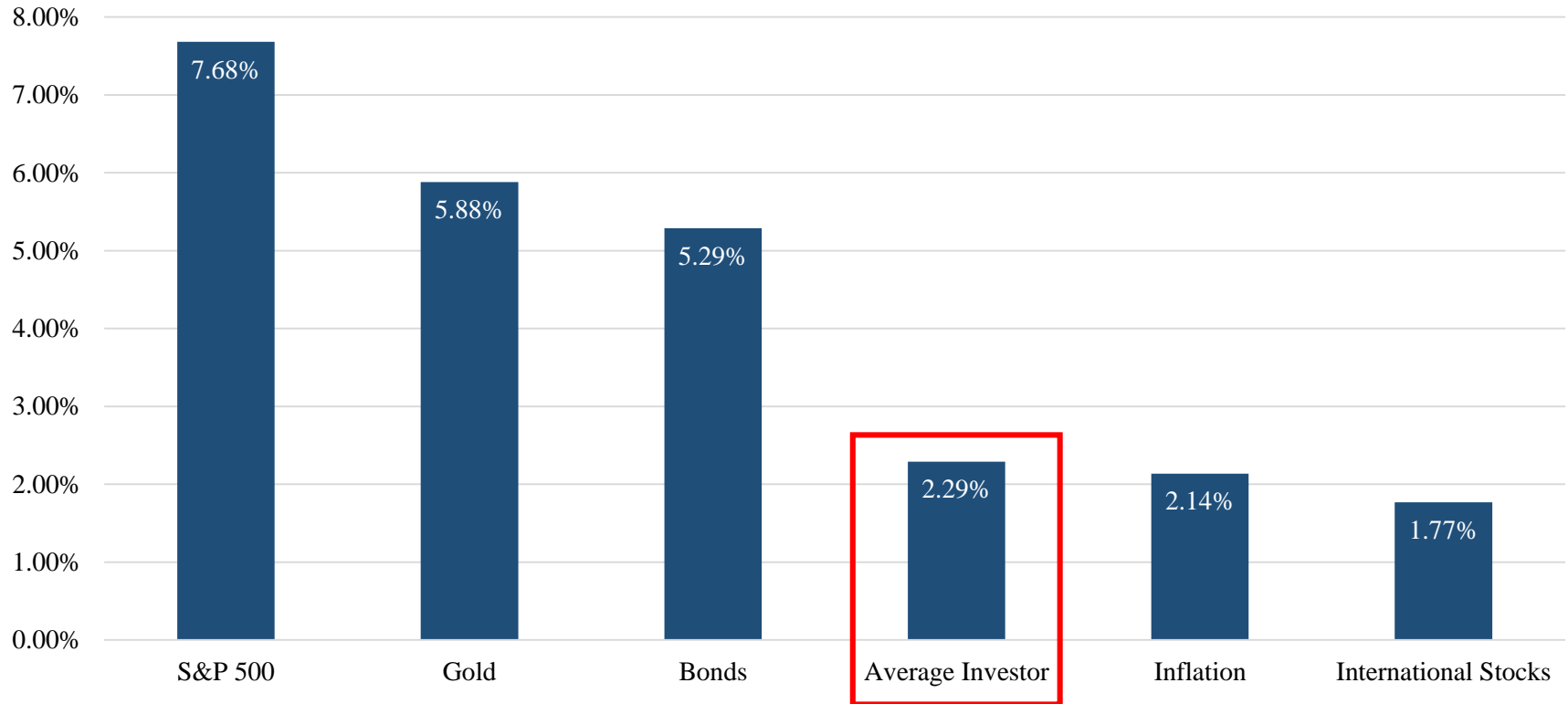
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# The Average Investor Underperforms

## 20-year annualized returns by asset class (12/31/1994 – 12/31/2016)



Sources: BlackRock; Bloomberg, Federal Reserve Economic Data (FRED), Yahoo, Dalbar, MSCI: Stocks are represented by the S&P 500 Index, an unmanaged index that consists of the common stocks of 500 large-capitalization companies, within various industrial sectors, most of which are listed on the New York Stock Exchange. Gold is represented by the change in spot price of gold in USD per ounce. Bonds are represented by the Barclays US Aggregate Bond Index, an unmanaged market weighted index that consists of investment-grade corporate bonds (rated BBB or better), Mortgages and US Treasury and government agency issues with at least 1 year to maturity. Average Investor is represented by Dalbar's average asset allocation investor return, which utilized the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/16 to match Dalbar's most recent analysis. Inflation is represented by the Consumer Price Index (for All Urban Consumers). International Stocks are represented by the MSCI EAFE Index, a broad-based measure of international stock performance.

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## Making Up Losses

When we experience a downturn in any investment class, what many investors may not realize is just how difficult it is to then make up that loss. For example, a 50% loss would require a 100% gain just to break even – a concept known as negative compounding.

Potential portfolio investment loss	Gain required to get back to even
-10%	+11%
-20%	+25%
-30%	+43%
-40%	+67%
-50%	+100%
-60%	+150%

*Source: Wakina Consulting Inc. 2016. For illustrative purposes only.  
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**Why Have the Markets Been So Volatile?**

**Is Volatility Here to Stay?**

# Why Have Markets Been So Volatile?

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## Short-Term Volatility

- Algorithmic trading
- Late-stage bull market
- Advanced stage growth cycles

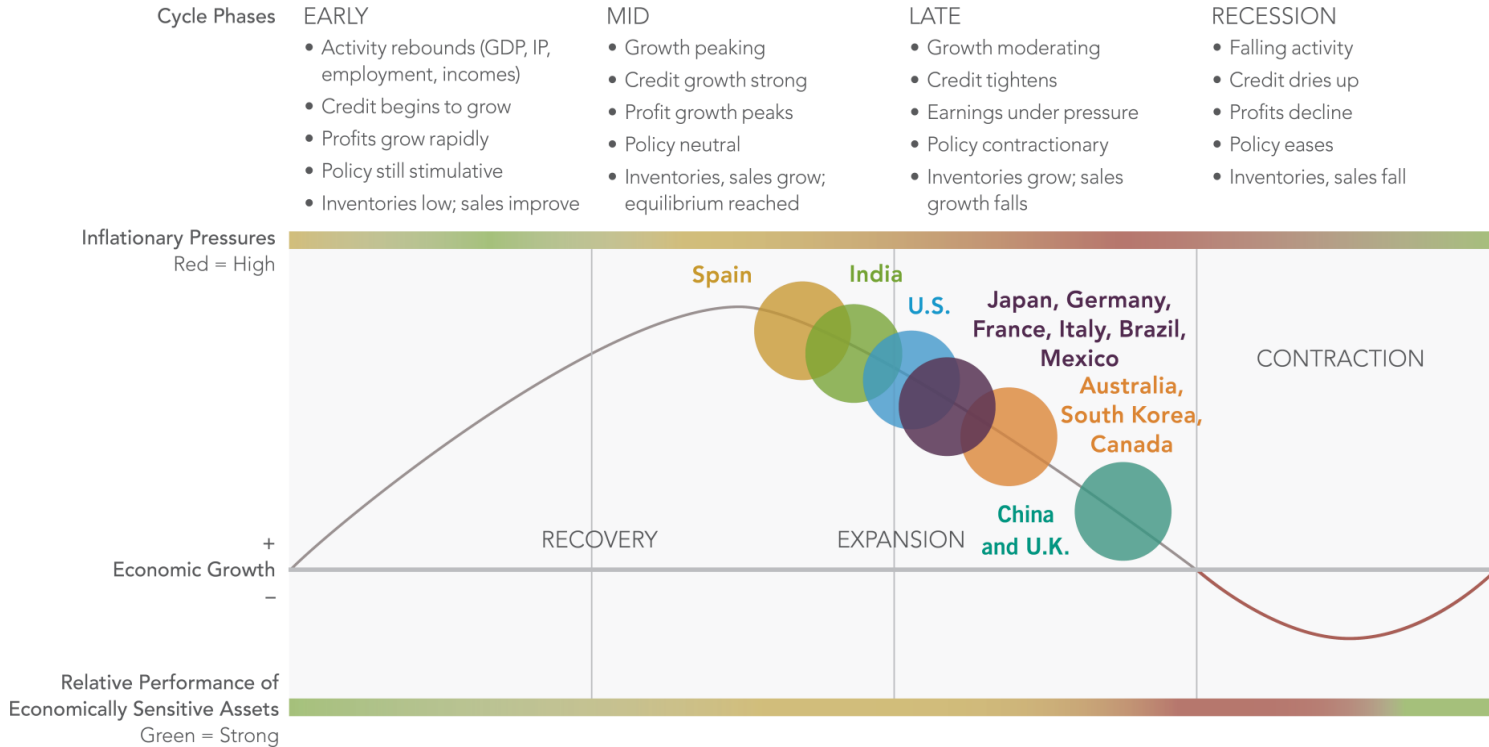
## Long-Term Volatility

- Quantitative Easing
- Global trade issues
- Investor emotion

# U.S. and Global Cycles Continue to Mature

Global expansion remains solid, but many major economies have progressed toward more advanced stages of the business cycle.

## Business Cycle Framework



*Note: The diagram above is a hypothetical illustration of the business cycle. There is not always a chronological, linear progression among the phases of the business cycle, and there have been cycles when the economy has skipped a phase or retraced an earlier one.*

*Source: Fidelity Investments (Asset Allocation Research Team "AART"), as of 9/30/18.*

*Slide courtesy of Fidelity Investments: Quarterly Market Update for Q4 2018.*

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## U.S. Economy a Mix of Mid- and Late-Cycle Dynamics

The U.S. has remained on a very gradual progression through its business cycle, with mid-cycle dynamics staying solid in the credit and inventory cycles, but with late-cycle trends growing more evident after years of tightening labor markets and gradually firming wage growth.

### Mid- to Late-Cycle Phase Transition

Indicator	Typical Late-Cycle Trends	Current Dynamics	
		Mid-Cycle	Late-Cycle
Corporate Profits*	Margins decline	●	●
Inventories	Rise relative to orders	●	
Employment	Tight conditions		●
Wage Growth	Accelerates		●
Monetary Policy	Fed tightens, yield curve flattens		●
Credit	Lending standards tighten	●	

\*Listing of both blue and green circles indicates evidence of both mid- and late-cycle traits.

Source: Fidelity Investments (Asset Allocation Research Team "AART"), as of 9/30/18.

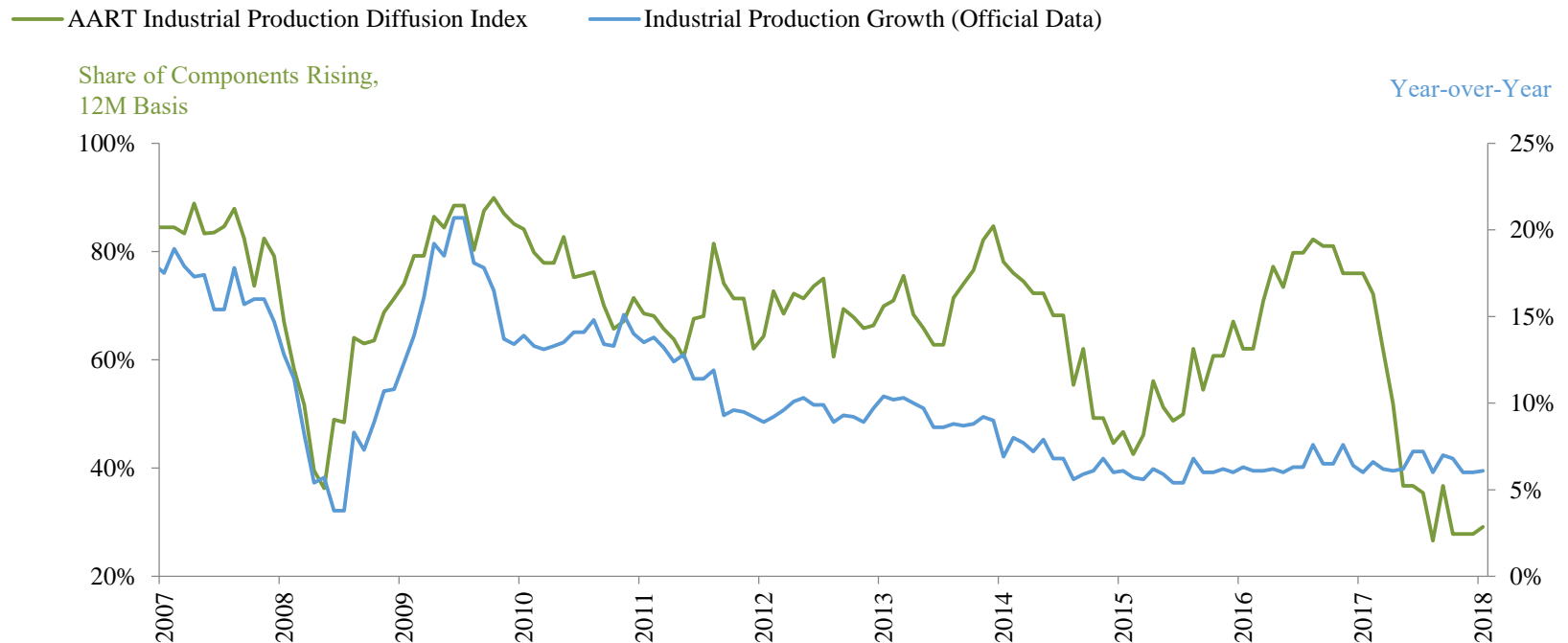
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# China Deceleration Challenges Policymakers

Fidelity’s Industrial Production Diffusion Index continues to signal significant weakness in China, and during Q3 China acknowledged the slowdown by fully shifting toward an easing stance. Policymakers there face a delicate balance of trying to ease conditions while, at the same time, not adding to elevated debt levels, a task made more difficult by an external sector no longer in surplus and facing rising U.S. trade barriers.

## China Industrial Activity



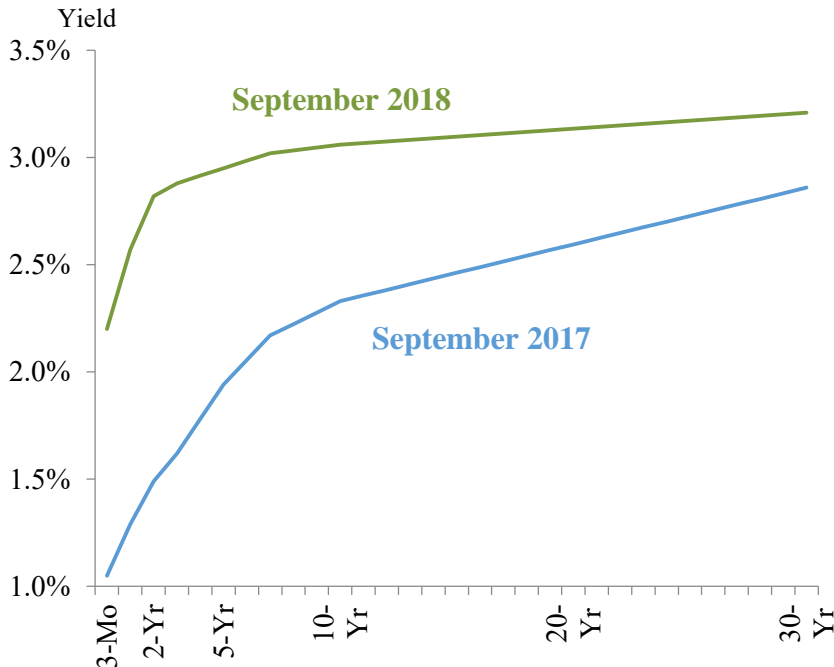
The external sector involves a country’s economic interactions—e.g., exports, imports, and capital flows—with other countries.  
 Source: China National Bureau of Statistics (official data), Bloomberg Financial L.P., Fidelity Investments (Asset Allocation Research Team “AART”), as of 8/31/18.  
 Slide courtesy of Fidelity Investments: Quarterly Market Update for Q4 2018.  
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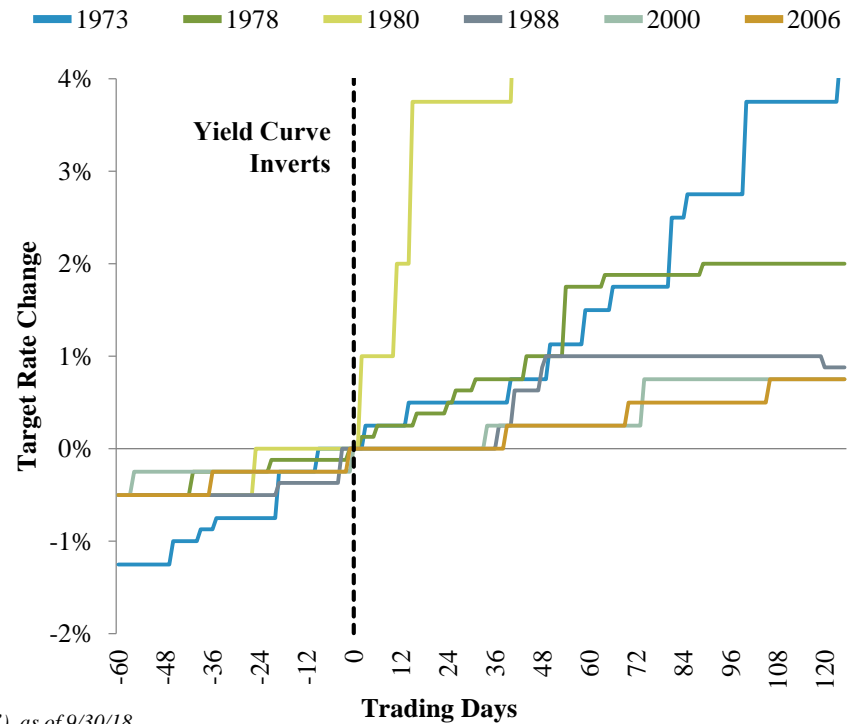
# Fed Typically Hikes Through a Yield Curve Inversion

In September, the Fed raised rates for the eighth time this cycle, further flattening the yield curve. Over the past six tightening cycles, the Fed has responded to falling unemployment and rising wages by continuing to raise rates, even after the curve became negatively sloped. This suggests to us that if wages are rising and labor markets remain tight, the Fed is likely to continue raising rates even if the yield curve inverts.

## U.S. Treasury Yield Curve



## Fed Funds Rate at Yield Curve Inversions



**LEFT** Source: Bloomberg Financial L.P., Fidelity Investments (Asset Allocation Research Team "AART"), as of 9/30/18.

**RIGHT:** Includes instances when the 10–2 year Treasury yield curve initially inverted during Fed tightening cycles. Source: Federal Reserve Board, Bloomberg Financial L.P., Fidelity Investments (Asset Allocation Research Team "AART"), as of 9/30/18.

Slide courtesy of Fidelity Investments: Quarterly Market Update for Q4 2018.

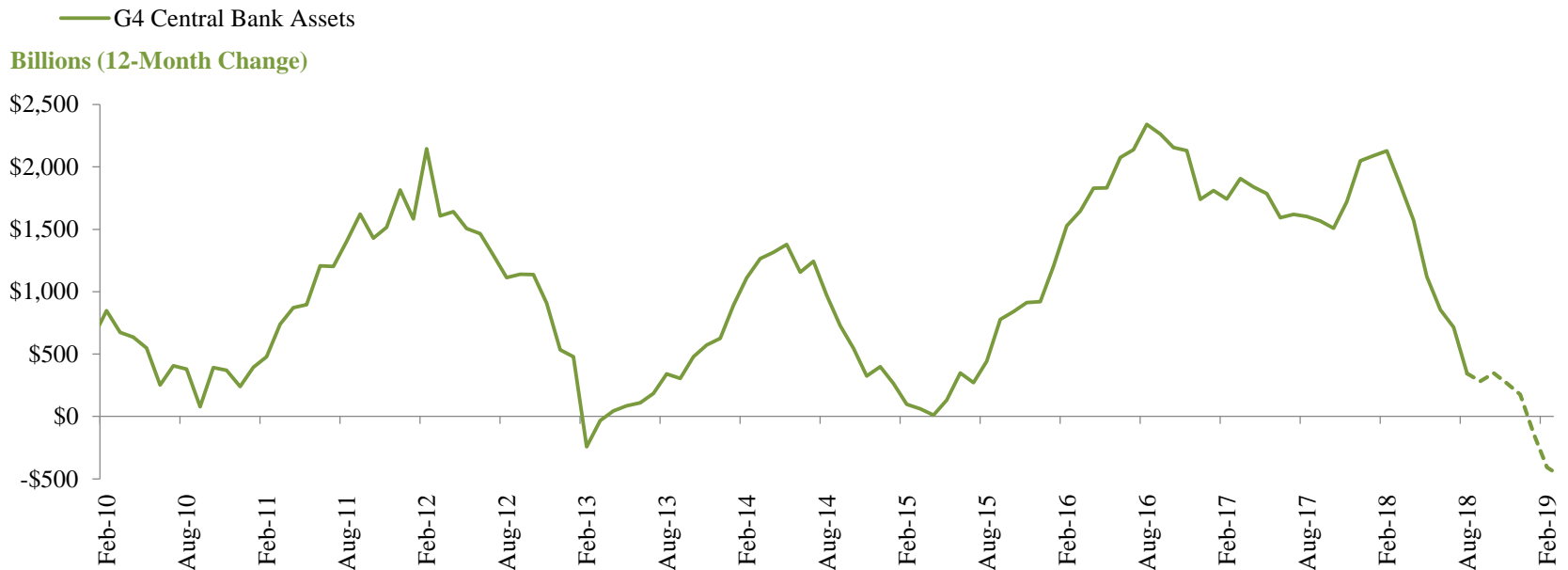
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# QE Unwind Is Challenging Global Liquidity Growth

As the Fed further reduces its balance sheet and the ECB ends quantitative easing at year end, growth in major central-bank balance sheets is expected to turn negative by Q1 2019. After an unprecedented post-crisis period of global monetary easing, the paring of liquidity may challenge demand for less liquid assets such as high-yield bonds and emerging-market securities, potentially contributing to elevated asset-market volatility.

## Fed, ECB, BOJ, BOE Balance Sheets and Asset Flows



Fund Flows: Mutual funds and ETFs. EME: Emerging-Market Equity. EMD: Emerging-Market Debt. HY: High-Yield Debt.

Dotted line estimates future central bank assets: Fed to roll off balance sheet assets by lesser of stated caps or total bonds maturing each month; ECB to purchase EUR15B per month in Q4; BOJ to purchase at annualized rate of average purchases over last 12 months; BOE to keep balance sheet constant. Source: Federal Reserve (Fed), Bank of England (BOE), European Central Bank (ECB), Bank of Japan (BOJ), EPFR, Haver Analytics, Fidelity Investments (Asset Allocation Research Team "AART"), as of 8/31/18.

Slide courtesy of Fidelity Investments: Quarterly Market Update for Q4 2018.

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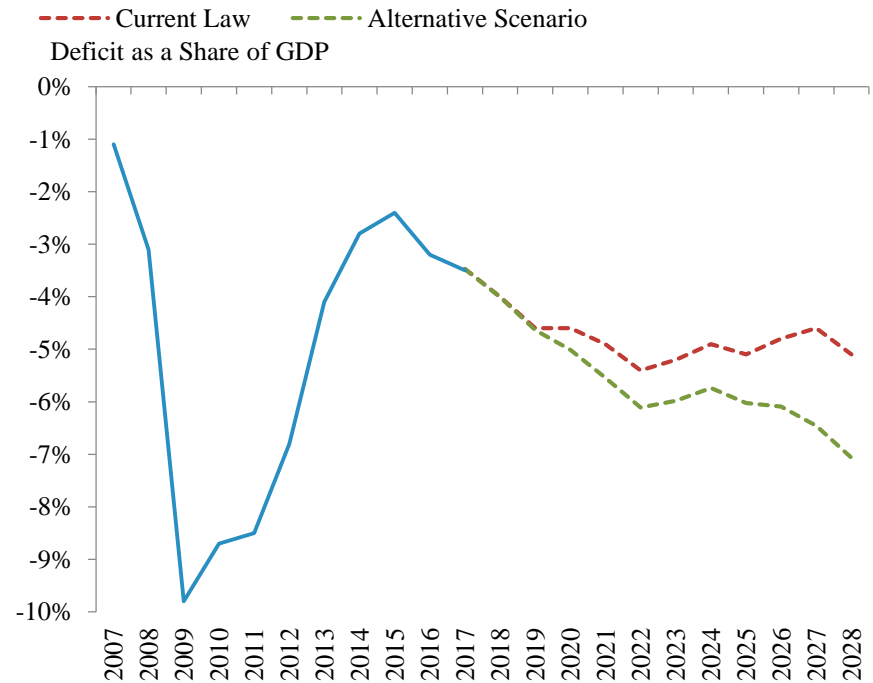
# U.S. Economic Policies Likely More Mixed in 2019

Favorable policy conditions have supported the U.S. corporate sector during 2018, including tax cuts, fiscal stimulus, and a lighter regulatory stance. However, policy may provide less of a tailwind in 2019 amid the fading boost from corporate tax cuts, the likely continuing rate hikes by the Federal Reserve, the cumulative drag from higher U.S.–China tariffs, and potential medium-term concerns about the trajectory of the U.S. fiscal deficit.

## Economic Policy Scorecard

	2018	2019	Potential Trend Change
Deregulation	+	+	
Tax cuts	+++	+	Fading effect
Fiscal spending	+	+	
Monetary policy		-	From normalization to tightening?
Trade	-	--	From small headwind to bigger one?

## U.S. Fiscal Deficit



**LEFT:** Source: Fidelity Investments (Asset Allocation Research Team “AART”), as of 9/30/18.

**RIGHT:** Alternative scenario, projected by the CBO, assumes various expiring policies will be extended, including recent tax cuts and higher budget caps.

Source: Congressional Budget Office, Haver Analytics, Fidelity Investments (AART), as of 4/8/18.

Slide courtesy of Fidelity Investments: Quarterly Market Update for Q4 2018.

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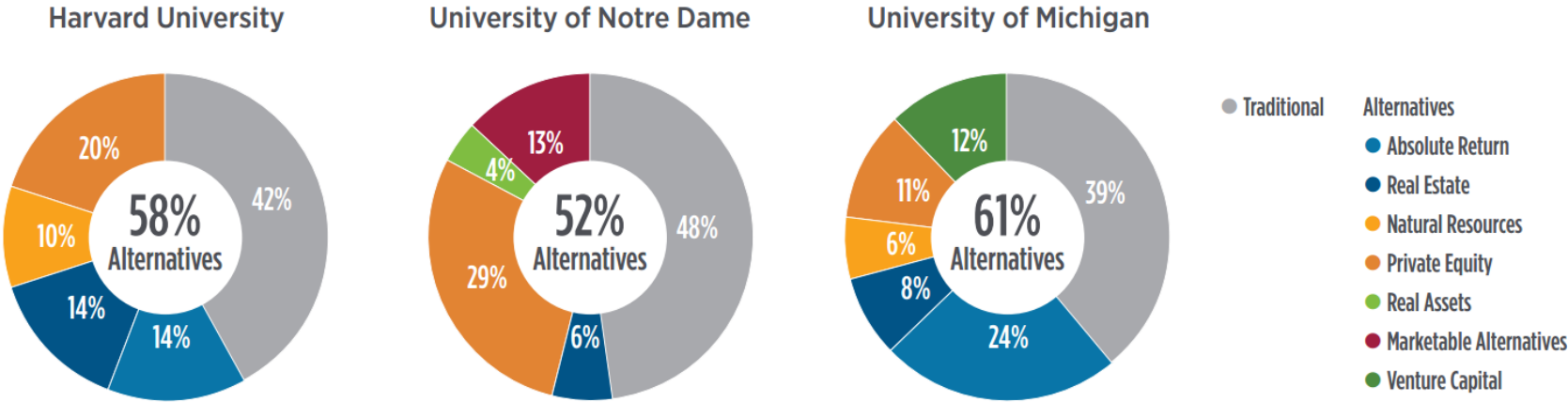
# Avoiding Volatility

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# Private Assets – How Well-Executed Endowments Invest

## Alternative investments dominate portfolio allocations of top U.S. university endowments



Source: University filings for FY2016. Allocations reflect available data and in some cases non-endowment assets. Securities offered through Frontier Solutions, LLC (Member FINRA/SIPC)

## Common Types of Private Assets

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Private Equity



Private Debt



Real Assets (Including Real Estate)

## The Value of Private Assets

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- Opportunity to exploit market inefficiencies
- Help combat low interest rate environment
- Low correlation
- Improved risk/return characteristics
- Overall portfolio diversification

# The Value of Private Assets: Opportunity for Alpha

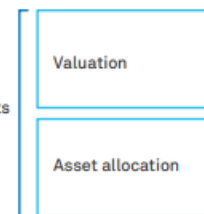
## Private Investments



Private Investments Dispersion

The wider array of value levers and risk drivers in private markets can result in greater performance dispersion vs. public assets

## Public Investments



Public Investments Dispersion

- ▶ **Sourcing:** Access to investment opportunities is selective and often made discretely.
- ▶ **Private information:** Relevant data is largely private. Selective disclosure is not restricted, it is the norm.
- ▶ **Structuring and negotiation:** Custom structures and security features are more widespread in privately negotiated transactions, and pricing is more likely to be impacted by non-economic factors, such as time pressures to get a deal done.
- ▶ **Valuation:** Comparables are often difficult to find or rely on for unique assets, requiring more work to establish intrinsic valuations.
- ▶ **Asset allocation:** Includes both active allocation to public market risk premiums and assessment of the illiquidity premium, which changes significantly over time.
- ▶ **Use (or misuse) of leverage:** Leverage and debt covenants are more varied than in public markets.

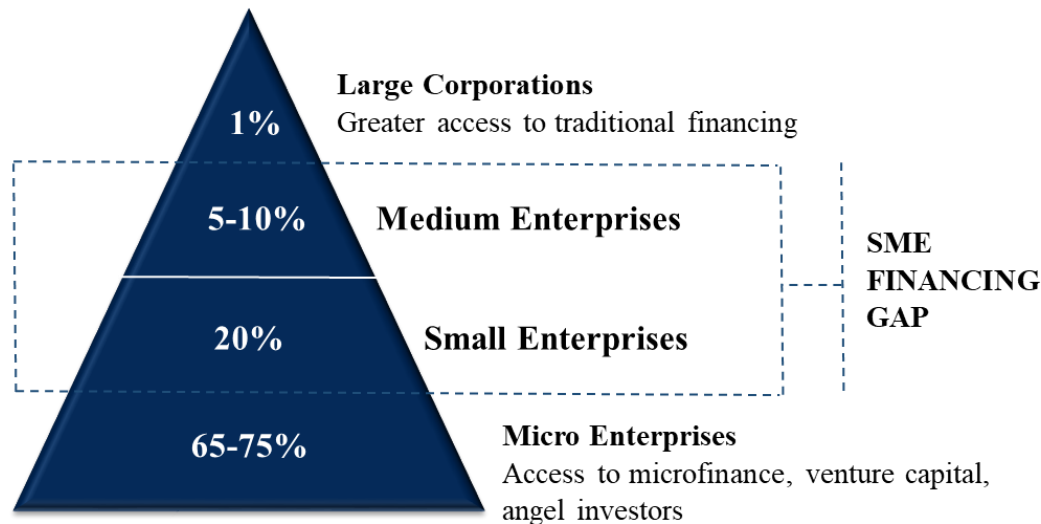
Slide courtesy of BlackRock © May 2015

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# Market Inefficiencies

Access to affordable capital for Small and Medium-Sized Enterprises (“SMEs”) is significantly limited in Emerging Markets.<sup>1</sup>

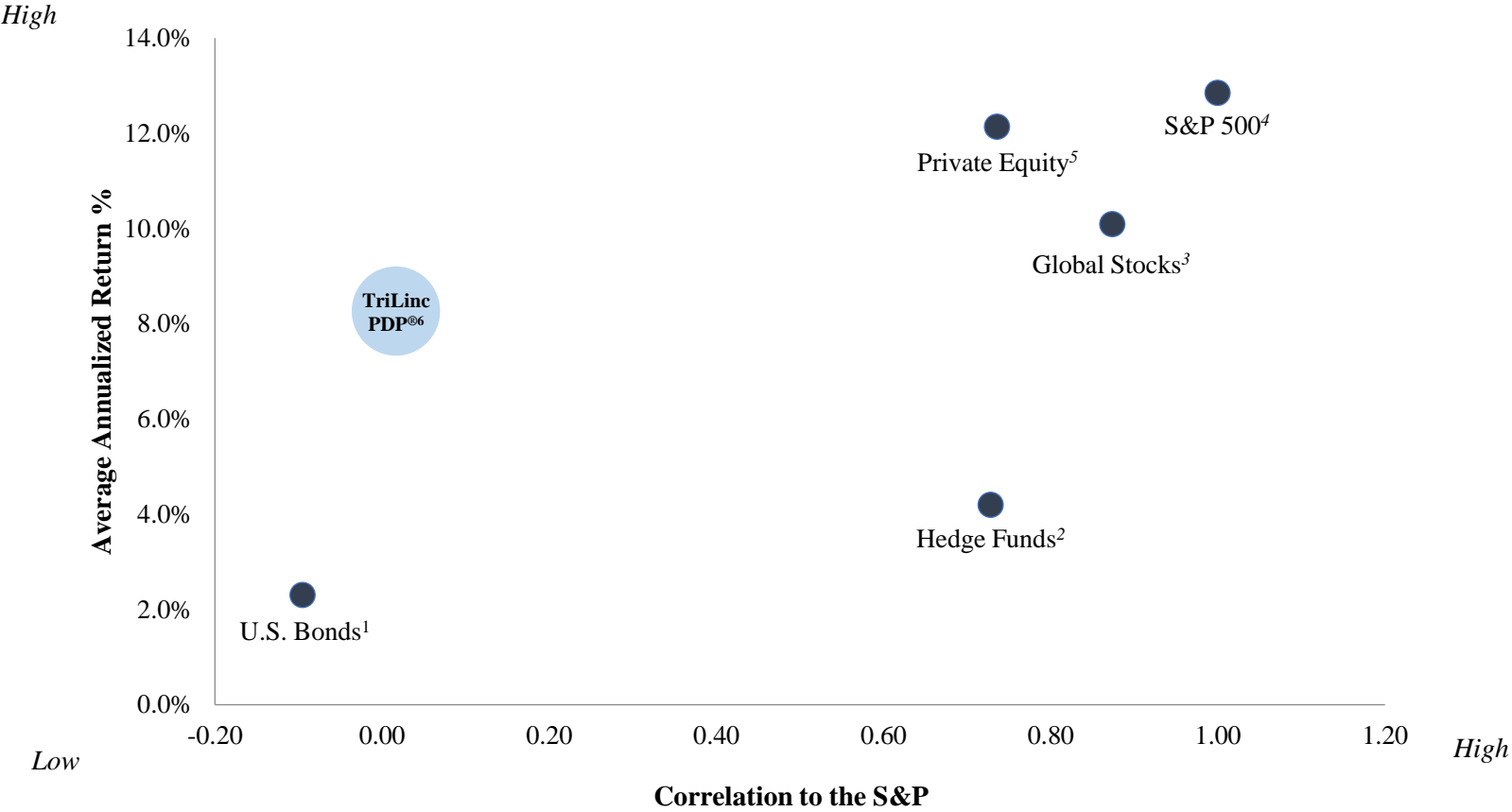


**The International Finance Corporation has estimated that unmet demand for SME financing in developing economies is as much as \$1.1 trillion.<sup>1</sup>**

<sup>1</sup>Source: “Closing the Credit Gap for Formal and Informal MSMEs,” International Finance Corporation, 2013, Washington, DC: IFC Securities offered through Frontier Solutions, LLC (Member FINRA/SIPC)

# Low Correlation

Period: Since Inception 6/30/13 – 3/31/18



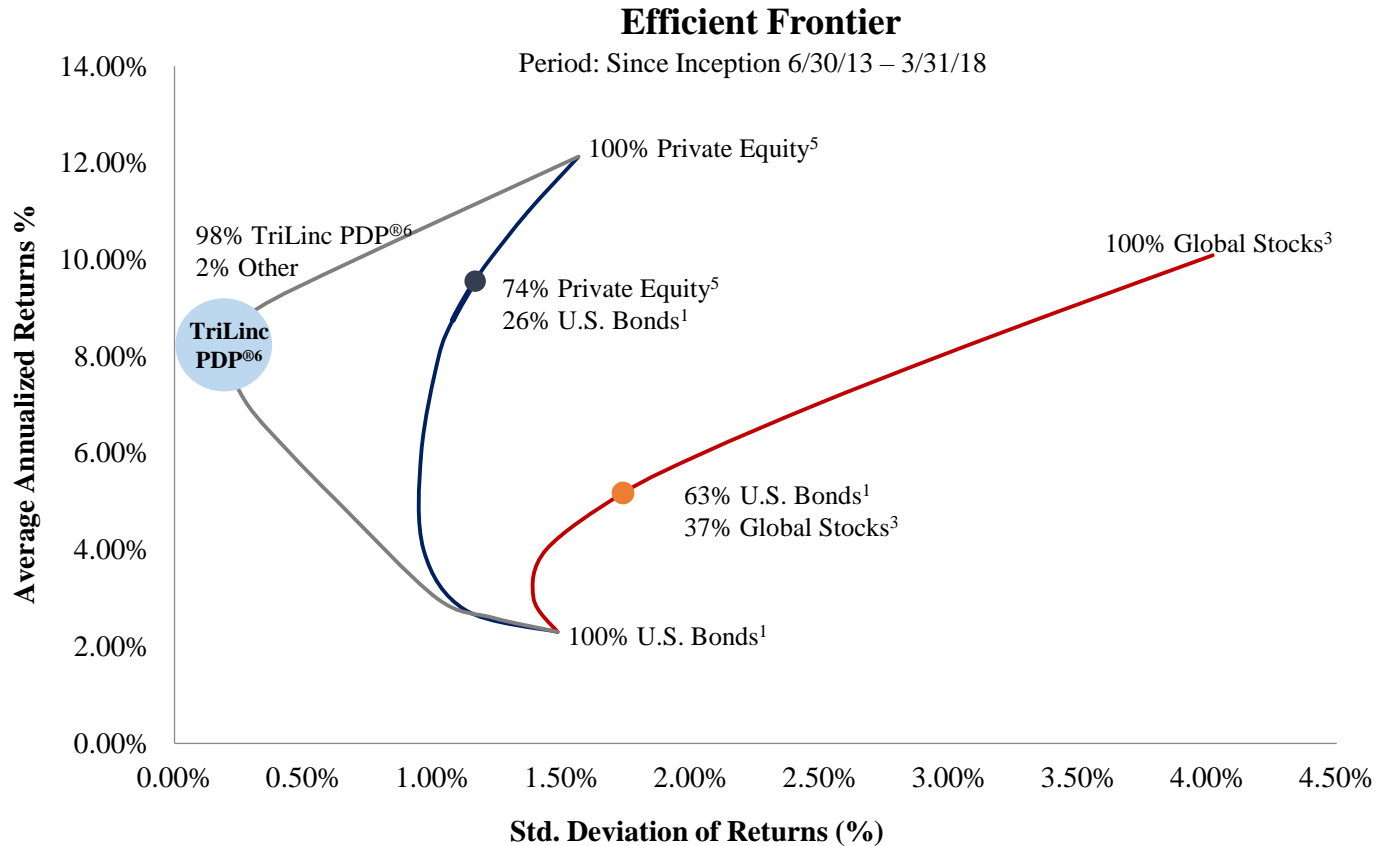
Please see footnotes on Slide 26.

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# Improved Risk/Return Characteristics



— Global Stocks<sup>3</sup>, U.S. Bonds<sup>1</sup>, Private Equity<sup>5</sup>, Hedge Funds<sup>2</sup>, and TriLine PDP<sup>6</sup>

— Global Stocks<sup>3</sup>, U.S. Bonds<sup>1</sup>, Private Equity<sup>5</sup>, Hedge Funds<sup>2</sup>

— Global Stocks<sup>3</sup>, U.S. Bonds<sup>1</sup>

Please see footnotes on Slide 26.

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## Footnotes

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### *Slide 24:*

Methodology: The efficient frontier was constructed using average annualized quarterly returns (%) and no risk-free asset. Using a weighted covariance table, the lowest variance for a given expected return was discovered using mean variance optimization. Equivalently, a portfolio lying on the efficient frontier represents the combination offering the best possible expected return for a given risk level. The optimal allocation was discovered by maximizing the slope, providing the highest return to risk ratio. The analysis was conducted from 6/30/13 to 3/31/18, providing 19 data points for each asset class. While 30 samples is generally considered a boundary between small and large samples, Private Debt Plus® is limited by historical return results.

### *Slides 24 and 25:*

Performance displayed does not reflect the reinvestment of distributions and is net of expenses.

Results reflect the performance of Private Debt Plus® which consists of asset based weighted returns of TriLinc Global Impact Fund (TGIF) and TriLinc Global Sustainable Income Fund (TGSIF) and does not reflect the performance of the Funds individually (except as noted) or other investment vehicles. Cash flows from TGSIF are added to cash flows from TGIF as of the end of each month and not as of the actual transaction date of the cash flow as in the case for the TGSIF standalone IRR calculation. No investor actually received the returns shown.

<sup>1</sup>iShares Core US Aggregate Bond ETF (AGG) seeks to track the investment results of an index composed of the total U.S. investment-grade bond market.

<sup>2</sup>HFRI Asset Weighted Composite Index is designed to capture the breadth of hedge fund industry performance trends across all strategies and regions. The index is weighted according to the AUM reported by each fund for the prior month.

<sup>3</sup>iShares MSCI ACWI ETF(ACWI) seeks to track the investment results of an index composed of large and mid-capitalization developed and emerging market equities.

<sup>4</sup>SPDR S&P 500 ETF (SPY) seeks to provide investment results that, before expenses, correspond generally to the price and yield performance of the S&P 500® Index which is a diversified large cap U.S. index that holds companies across all eleven GICS sectors

<sup>5</sup>Prequin Private Equity Quarterly Index, December 2017. This is a money-weighted index that uses fund-level cash flow transactions and net asset values for over 4,000 private equity funds collectively worth more than \$3 trillion.

<sup>6</sup>Private Debt Plus® Net IRR Estimate

# Private Debt Plus<sup>®</sup> Strategies

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# Private Debt Plus<sup>®</sup>

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## Interest Rate Risk

- Short Duration (< 3 years)

## Credit Risk

- Primarily Senior Secured 1<sup>st</sup> Lien
- Over Collateralized using Liquidation Values

## Market Risk

- Primarily Direct Origination Loans
- Income Basis Valuation
- 100% USD Denominated<sup>1</sup>

## Sector Risk

- Comprehensive Diversification
  - By Originator
  - By Asset Type (Trade Finance vs. Term Loan)
  - By Region
  - By Country
  - By Sector

## Geopolitical Risk

- No Government Loans – All Private Sector Companies
- Very Select Developing Economies
  - Growing
  - Stable
  - Accessible

<sup>1</sup>Principal balances and repayments are denominated in US dollars; interest payments on loans in Europe may have foreign currency exposure to the Euro.

Although TriLinc believes, based on certain factors and assumptions, that the target risk profile outlined above is reasonable, it is not guaranteed.

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## Private Debt Plus<sup>®</sup> Key Statistics (as of 12/31/18)

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**\$1.16 billion**

Trade finance, term loan, and short-term transactions in

**83**

Small & Mid-Sized Businesses supporting

**35,820**

Permanent jobs<sup>1</sup> in

**36**

Developing economies<sup>2</sup>

**0**

Default Losses<sup>3</sup>

<sup>1</sup>“Permanent Jobs” is based on the IRIS Metric of Permanent Employees

<sup>2</sup>TriLinc supports impactful trading operations, benefiting exports and/or imports into developing economies. For borrower companies that are located in developed markets, TriLinc provides trade financing transactions involving exports/imports for enterprises located in developing economies. The transactions involving these developing economy enterprises are included in the figures above.

<sup>3</sup>To date, TriLinc has not realized any loan losses, however the value of some loans have been marked down from their original loan amount and in such cases may no longer be accruing interest.

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## Want to Learn More?

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or you can visit us online at:

[www.trilincglobal.com](http://www.trilincglobal.com)



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Thank You!